Public Utility Commission of Texas
7800 Shoal Creek Boulevard
Austin, Texas 78757 • 512/458-0100

Marta Greytok
Commissioner

Robert W. Gee
Chairman

Karl R. Rábago
Commissioner

February 24,1993

Donna R. Searcy, Secretary
Federal Communications Commission
1919 M. Street, N.W.
Washington, D.C. 20554

RE: CC Docket No. 92-296
In the Matter of Simplification of the Depreciation Prescription Process

Dear Ms. Searcy:

Enclosed for filing are an original and nine copies of the Public Utility Commission of Texas' comments concerning the proposals for Simplification of the Depreciation Prescription Process.

Sincerely,

Rowland L. Curry
Director
Telephone Utility Analysis Division

Enclosure

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Simplification of the Depreciation Prescription Process	)	CC Docket No. 92-296
	)	

COMMENTS OF THE PUBLIC UTILITY COMMISSION OF TEXAS

In response to the Federal Communications Commission's (FCC's) Notice of Proposed Rulemaking released December 29, 1992 in the above captioned proceeding, the Public Utility Commission of Texas (PUC of Texas) hereby submits its comments in connection with the proposed simplification of the depreciation prescription process. In the Notice of Proposed Rulemaking, the FCC has proposed four distinct options to develop a depreciation prescription process that would replace the current process. The stated purpose of these proposals is to reduce the regulatory burden and the associated cost to the utilities.

The PUC of Texas supports the concept of eliminating studies that are costly and unnecessary, to ease the burden on ratepayers and taxpayers alike. However, we have serious concerns about several aspects of the FCC's proposals. We are not convinced that the alleged benefits of the proposals will be worth the loss in actual data analysis. We believe that the development of reasonable depreciation factors continues to be necessary, even in this era of increased competition and regulatory flexibility.

We will offer comments on each of the four basic proposals, followed by our perspectives on other relevant issues.

The first proposal, the basic factor range option, is intended to simplify the depreciation process by establishing ranges for the three basic factors that determine the parameters used in the depreciation rate formula; the future net salvage (FNS), and the projection life and the survivor curve [the basic factors that determine the average remaining life (ARL)]. This would eliminate the need for carriers to submit detailed studies in support of their proposed factors.

The FCC seeks comment on how the range of factors would be set, how the carriers would select a factor from within the range, how often a carrier would be allowed to change its factor, and what the review process should be.

The PUC of Texas would first comment that we are not convinced that any of the four options offer benefits through significant cost savings that would outweigh the social cost of losing valuable data and analysis. That having been said, it is our position that this first option, with fairly substantial modification, would be the most acceptable of the four proposals offered. We believe it may be reasonable to allow all carriers to use common factors in the calculation of depreciation rates for many of their minor plant accounts. This option would be more palatable if there were not a range of factors involved, but more simply, nationwide standards for each factor for each minor account. These factors would be coupled with the dynamic investment characteristics of each carrier to yield the appropriate rates for the carrier. If a range of factors is used, the carriers will likely continue to perform costly studies to determine where the factors should be set, or whether they should be changed.

We would view this option, as modified, especially applicable to certain categories of plant that are not subject to wide variations of retirement patterns due to technology, competition, and regulatory policy changes. However, for those same accounts, periodic studies (e.g., every eight years) may continue to be needed to assess changes in the impact of technology, competitive forces, and regulatory policies. In fact, the current process already embodies aspects of this option for minor accounts in order to minimize the study time.

If standard factors were used, it would be most logical for them to be initially set based on some process involving national averages, coupled with the judgement of the

FCC's depreciation professionals. If these standards resulted in a significant expense shift, it would appear reasonable to allow a phased-in approach.

We do not believe that this method, or any of the others, should be used for "major" categories of investment, or for those categories that have historically displayed sufficient variability in factors or parameters to warrant more detailed data analysis. For the purpose of this discussion, we would consider "major" categories as those individual categories that contain more than 10 per cent of the carrier's total investment. The cost of studies for the major categories is far outweighed by the relative precision of the result. Very small changes in parameters in the calculation of rates for the major accounts have a very large impact on the overall expense to the carrier.

The PUC of Texas currently uses methods similar to this option in the establishment of intrastate depreciation rates for small carriers. However, the underlying assumption is that the larger carriers, upon which the small carriers pattern their factors, have performed reasonable studies to establish their own factors.

The second proposal, the range of rates option, would simplify the depreciation process by establishing ranges for depreciation rates to be used in calculating the annual depreciation expense.

The FCC has requested comment on this option, including the quantification of cost savings that result, the mechanics of establishing the ranges, and other items.

The PUC of Texas does not support this option for use by large carriers. Depreciation rates are currently set using methods that take into account each carrier's unique investment and retirement patterns. The rates should be set and monitored over time to ensure that the capital recovery is complete at the time the plant is retired. Such methods require pertinent data and study.

This option lacks the systematic approach of the current process in determining the depreciation rate that closely matches the rate of consumption of the asset of a particular carrier. This option would almost assuredly result in an accumulated depreciation

imbalance by not allowing the fine tuning of the current capital recovery processes such as the straight line remaining life and the equal life group methods.

It is inconceivable how this option could reduce costs, since carriers would continue to perform standard studies in order to determine their individual rate within the established range. The PUC of Texas urges the FCC to carefully analyze the detail contained in carriers' comments quantifying cost savings.

The third proposal, the depreciation schedule option, would simplify the depreciation process by establishing a depreciation schedule for each plant account.

The FCC invites comments on the method of establishing the schedule, the accounts to be treated in this manner, and other questions similar to those in the previous options.

The PUC of Texas does not support this option for use by the FCC, for many of the same reasons it did not support the second option, above. Adoption of this option would not recognize the individual carrier's rate of consumption, future planning and construction activity, and the individual regulatory policies concerning telecommunications investment. There is a high probability that such an option would result in an imbalance in accumulated depreciation, especially in a dying account.

The fourth proposal, the price cap carrier option, would simplify the depreciation process by allowing price cap carriers to file for approval of depreciation rates with no supporting data. The FCC would prescribe depreciation rates after public notice and comment.

The FCC seeks comments on whether price cap carrier should be allowed this expanded degree of flexibility, since it is argued that increases in depreciation expense do not generally affect customer rates under price cap regulation.

The PUC of Texas does not support this option, for a number of reasons. First, the FCC must recognize that there is a wide assortment of regulatory experimentation being conducted throughout the country; however, only a few states have adopted the price cap methodology prescribed by the FCC. Although the states are no longer bound by the FCC-prescribed interstate depreciation rates, those same rates are generally adopted for the intrastate portion of the carrier's assets. This is based in large part on the fact that the

FCC undertakes a thorough study of depreciation parameters at the interstate level in order to support its decisions. While interstate rates under the FCC's price cap plan would not necessarily be affected by changes in depreciation expense, an intrastate impact would result in Texas from such changes since we use an earnings sharing plan for Southwestern Bell in our jurisdiction. Even if the FCC were to no longer require supporting data to set interstate rates, most states would continue to require such data for decisions that affect intrastate rates. As a result, the level of cost savings realized through this option would be minimal.

Second, we wish to emphasize that depreciation rates in the various accounts are used for purposes far beyond the traditional setting of revenue requirement. Many functionalities and services are currently being priced based on incremental costs, which are, in turn, based on depreciation rates. We are concerned that the use of the fourth option would increase the possibility of establishing rates for capital recovery based on dynamic factors other than those related to plant investment.

Third, we are concerned about the ability of the public, including the state regulatory agencies and the carriers' competitors, to rationally comment on the filings under this plan in the absence of any supporting data.

In sum, it is our position that adoption of the fourth proposal would adversely affect several aspects of regulation and would prevent the analysis of supporting data, all for the sake of unquantified cost savings. While this plan does not directly delegate authority for depreciation ratemaking to the carrier, it appears to abdicate decisionmaking in this important area.

The Notice specifically requested comments on whether the fourth approach would be consistent with Section 220(i) statutory requirement. While the FCC has broad discretion to interprete the statute, the proposal to cease the "three-way meetings" and drop the requirement that the utility provide currently required supporting data would violate U.S.C.A. §220(i) because it would not be providing the states with "reasonable opportunity"

to present its views as required. If the state has no supporting data or analysis to justify the utility's proposed depreciation rate, the FCC will have usurped from the state the very "opportunity" which §220(i) requires. The state would not be able to "present its views" because the FCC would have removed the only information upon which such views could be formed. This proposal would essentially negate the entire regulatory scheme contemplated under the statute.

Other Issues:

The PUC of Texas has serious concerns about the quantification of cost savings in the event that one of the FCC's proposals is adopted. Even if one assumed that all states were to agree with the FCC's simplification plan, there would continue to be the necessity for a core amount of depreciation analysis to be performed by all carriers. We again urge the FCC to carefully examine the comments regarding the quantification of cost savings.

We are also concerned that the proposed options will generally hinder the evaluation of requests for increases in depreciation as a result of the evolution of technology. The absence of supporting data (in varying degrees, depending on the plan) is troublesome. We have recently been beset by assertions by carriers that traditional regulation stifles accelerated investment and infrastructure modernization. Data trends, however, show that increased depreciation rates have no bearing on the willingness of carriers to make additional investments. The current prescription process appropriately reflects the carriers' deployment of new technology.

It is worthwhile to note that the current study process has already been streamlined and automated to a great extent. The quality of analysis has clearly improved. If the normal trend of reduced cost through improved data processing is any indication, the cost of studies should indeed be lower in the future. We believe the emphasis should be on making the current study process more efficient, rather than reducing the depth or the scope of study.

The Notice requested comments on the appropriate time interval for reviewing changes in depreciation parameters or rates. The PUC of Texas generally supports the reduction in cost that would occur if the frequency of study is lengthened from three years. If the frequency were lengthened to four years, it could be scheduled to work within the effective period of price cap regulation.

The Notice also requested comments on whether the process should be changed with respect to the consideration of future net salvage in setting depreciation rates. Under the FCC proposal, the cost of removal and salvage would be booked as current period charges and credits, and would be removed from the depreciation process. We believe the treating of salvage as current period changes would represent a change to GAAP. Treating salvage as a component of the depreciation process is specifically spelled out in Accounting Research Bulletin No. 43, Section C, §5 which states:

> The cost of a productive facility is one of the costs of the services it renders during its useful economic life. Generally accepted accounting principles require that this cost be spread over the expected useful life of the facility in such a way as to allocate it as equitably as possible to the periods during which services are obtained from the use of the facility. This procedure is known as depreciation accounting, a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation.

This passage clearly indicates that GAAP depreciation should take into consideration salvage value (if any) in the equitable allocation of the costs of a productive facility over its expected useful life. This in effect lowers the annual depreciation expensed and it reduces the total depreciation expensed (since total depreciation expensed is equal to the original cost of the asset less its salvage value).

If the salvage amount is only recognized at the end of the productive facilities life as a credit and not included in the annual depreciation recognition, the annual depreciation expense will be greater and the total depreciation expensed will be greater (total depreciation expensed will equal the original cost of the asset).

One situation where the proposed treatment of salvage will meet GAAP guidelines is when the salvage value is negligible or immaterial. In this situation, under GAAP guidelines, the salvage component used in calculating the depreciation expense would be ignored and depreciation would be calculated without a salvage component. This matches the proposed treatment of salvage.

Conclusion:

The PUC of Texas is concerned that any of the four proposals aimed at reducing the cost of depreciation analysis actually undermine the accuracy and fairness inherent in the current depreciation prescription process. We generally support attempts to lower costs through streamlining of the process, especially in minor accounts that are relatively stable, through the method described in our discussion of the first option. Major accounts and those which are subject to rapid changes due to new technology, competition, and other forces should be analyzed thoroughly to ensure that they are being properly treated by the carriers.

We urge the FCC to recognize the importance of depreciation rates well beyond the establishment of a traditional revenue requirement, in processes such as the development of cost-based competitive rates.

The Public Utility Commission of Texas appreciates the opportunity to comment on these proposals.

Respectfully Submitted,

The Public Utility Commission of Texas

Robert W. Gee
Chairman

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